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In re The Chicago, Rock Island and Pacific Railway Company (C. C. A. 7th, May 23, 1946) (unreported)

Supreme Court of the United States

OCTOBER TERM, 1946.

IN THE MATTER
of
THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,
Debtor.

CARTER H. HARRISON, JR., *et al.*, as a Protective Committee for the Debtor's Preferred Stock,
Petitioners,
vs.
JOSEPH B. FLEMING and AARON COLNON, as Trustees of The Chicago, Rock Island and Pacific Railway Company, *et al.*,
Respondents.

No. 524.

BRIEF OF RESPONDENTS:

1. METROPOLITAN LIFE INSURANCE COMPANY, AS REMAINING MEMBER OF THE FIRST AND REFUNDING GROUP,
2. TRUSTEES UNDER THE FIRST AND REFUNDING MORTGAGE,
3. TRUSTEE IN RESPECT OF THE SECURED 4½% BONDS, SERIES A,
4. PROTECTIVE COMMITTEE FOR THE GENERAL MORTGAGE BONDS,
5. TRUSTEES UNDER THE GENERAL MORTGAGE,
6. PROTECTIVE COMMITTEE FOR THE ROCK ISLAND, ARKANSAS AND LOUISIANA RAILROAD COMPANY FIRST MORTGAGE 4½% BONDS,
7. PROTECTIVE COMMITTEE FOR CHOCTAW, OKLAHOMA AND GULF RAILROAD COMPANY CONSOLIDATED MORTGAGE 5% BONDS AND CHOCTAW AND MEMPHIS RAILROAD COMPANY FIRST MORTGAGE 5% BONDS,

IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI BY PROTECTIVE COMMITTEE FOR THE DEBTOR'S PREFERRED STOCK.

Statement.

The Protective Committee for The Chicago, Rock Island and Pacific Railway Company 7% and 6% Preferred

Stock has applied to this Court for a writ of certiorari to review the order and decree of the United States Circuit Court of Appeals for the Seventh Circuit, dated May 23, 1946, affirming a United States District Court order entered June 15, 1945 approving a modified plan of reorganization for the Rock Island System, certified by the Interstate Commerce Commission to the District Court on May 1, 1944.

We respectfully submit that the petition of the Preferred Stock Committee for certiorari should be denied:

(1) Because the technical question sought to be presented, which the Petitioner calls (Petition, p. 6) an "important question of Federal law", was decided by the Circuit Court of Appeals in accordance with the decisions of this Court and those of other Circuit Courts of Appeals, and the contrary position of the Preferred Stock Committee on that question is plainly without merit; and

(2) Because the Preferred Stock Committee has no standing to present the other questions which it seeks to present, since such questions were not raised in the Courts below. The position of the Preferred Stock Committee on one such question is directly contrary to the point made by that Committee in both Courts below, and the position of the Preferred Stock Committee on all such questions is without merit.

Argument.

1. The technical question sought to be presented, which the Petitioner calls an "important question of Federal law", was decided by the Circuit Court of Appeals in accordance with the decisions of this Court and those of other Circuit Courts of Appeals, and the contrary position of the Preferred Stock Committee on that question is plainly without merit.

The Preferred Stock Committee did not contend below, and does not contend here, that there is any equity in the Debtor's property for the Debtor's stockholders (unless, contrary to settled law, interest during the bankruptcy proceedings on creditor's claims were disallowed).*

Instead of presenting any point of substance which could result in benefit to the stockholders of the Debtor, the Preferred Stock Committee urges a technical point of procedure before the Interstate Commerce Commission, with the claim that this procedural point has not been settled by this Court. In fact, throughout this proceeding the Preferred Stock Committee has followed the tactics of the Debtor itself, in not claiming any equity for the stock but urging technical procedural points which could not benefit the stock but only delay the reorganization proceedings. (*Cf.* Debtor's petition for a writ of certiorari in the same reorganization proceeding, filed August 19, 1946, and answered by these respondents by brief dated September 9, 1946.)

The technical procedural contention of the Preferred Stock Committee is that in a railroad reorganization under Section 77 of the Bankruptcy Act the Interstate Commerce

* Any contention that interest on creditors' claims is not entitled to the same recognition as principal is directly contrary to the specific point made by the Preferred Stock Committee in the Courts below, as hereinafter discussed in Point 2 (p. 11 below).

Commission is required by subsections (d) and (e) "to proceed *de novo*" on a re-reference of a plan to the Commission by the District Court for any correction (Petition, pp. 10-11).

By "to proceed *de novo*" the Preferred Stock Committee means that the Commission is to deal with the proceeding as if it were just beginning and no plan had been presented by the Debtor or by other interests, no hearings held by the Commission, no reports issued by the Commission on a plan, and no review of the plan made by the District Court. The Committee asserts that on a re-reference of a plan the Commission must wait six months before holding any hearings, during which time the Debtor is to be required to file a new plan and other interests may file plans (Petition, p. 13). The only exception now conceded by the Preferred Stock Committee is that the Commission may take into consideration evidence theretofore taken in the proceeding (Petition, p. 15).

In the present case the Rock Island plan was referred back to the Commission by order of the District Court entered June 25, 1943 (R., pp. 299-300).* The Commission held a hearing on September 1, 1943 and received evidence of the financial condition of the Debtor in the intervening years since the Commission's previous report, including the year 1943. The Preferred Stock Committee refused to offer any evidence at that hearing but merely filed a motion that the proceeding be "*de novo*".** The Commission is-

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* References so indicated are to the printed record on the Debtor's petition for a writ of certiorari (Docket No. 410, October Term, 1946) to review the same decision of the Circuit Court of Appeals for the Seventh Circuit which is sought to be reviewed in this proceeding.

** The implication of the Preferred Stock Committee that the Commission refused to take any evidence offered by the Preferred Stock Committee is simply contrary to fact. The record is clear that the Committee offered no evidence when asked if it wished to do so by the Commission. The question and answer were as follows (September 1, 1943 hearing, Tr., p. 4655):

> "Commissioner Porter (Interposing): You are going to ask permission to introduce testimony on these matters raised by this motion at this time?

sued its report on a new plan on January 3, 1944, and a supplemental report on May 1, 1944, which reviewed the operations of the Rock Island System since its previous report to the District Court, made new findings regarding the propriety of the capitalization of the System, and made new allocations of securities and cash among the creditors (R., pp. 245, 250). The claim of the Preferred Stock Committee that the Commission ignored the Rock Island earnings for the years 1941, 1942 and 1943 (Petition, p. 15) is flatly contradicted by the Commission's report.*

Consequently, the "important" contention of the Preferred Stock Committee comes down to this narrow point, that the Commission should not have held its hearings on the re-reference of the plan until after December 25, 1943—six months after the District Court's order of June 25, 1943 returning the plan to the Commission—, instead of on September 1, 1943.

When the *Milwaukee* case was sent back by this Court to the Commission because of a defect in the plan, this Court did not require the Commission to start anew. *Group of Institutional Investors* v. *Chicago, Milwaukee,*

Mr. McIntosh: Not today. It is a question of asking for an order by the Commission, and no testimony to be offered. Of course, the purpose is in the end, that is the basis of the motion."

* The Preferred Stock Committee states that the Commission used, in determining normal earning power, the earnings of the years 1936-1937 (Petition, pp. 17, 26-27). This is a complete misconception and shows the lack of familiarity of this Committee with the proceedings. In determining the new reorganization capitalization, the Commission expressly considered the earnings record of the Rock Island from 1921 on (R., pp. 139, 245, 250). The Commission used the earnings of the various mortgage divisions derived under the so-called "earnings and expense formula" for the period 1936-1937 only in determining the relative earning power of the various mortgage divisions in a period of low earnings, and used this relative earning power only for the purpose of allocating among them new First Mortgage Bonds, which were the only new securities carrying a fixed charge which would have to be met in years of depression as well as years of prosperity (R., p. 202 and p. 209, line 28). Income Bonds were distributed at the higher level of approximately $11,000,000 of earnings (R., p. 203 and p. 213, line 13); and the Preferred Stock at the still higher level of over $17,000,000 of earnings (R., p. 203 and p. 217, line 13), the two latter levels of earnings being far in excess of the 1936-1937 average.

St. Paul & Pacific Railroad Co., 318 U. S. 523 (1943). The Commission proceeded exactly as it did in the *Rock Island* case, and the plan it then certified was approved by the District Court. Appeals from such approval were dismissed by the Circuit Court of Appeals and certiorari was denied by this Court. *In re Chicago, M., St. P. & P. R. Co.*, 145 F. (2d) 299 (C. C. A. 7th, 1944); cert. den. 324 U. S. 857 (1945).

The same procedure was suggested by the Circuit Court of Appeals for the Second Circuit in the *New Haven* case. *In re New York, New Haven & Hartford R. Co.*, 147 F. (2d) 40 (C. C. A. 2d, 1945); cert. den. 325 U. S. 884 (1945).

The procedure also conformed to what this Court has said as to the Interstate Commerce Commission and the courts working together to carry out Section 77. *Palmer* v. *Massachusetts*, 308 U. S. 79, 87 (1939); *Warren* v. *Palmer*, 310 U. S. 132, 138 (1940).

There is nothing in subsection (e) of Section 77 which requires the Commission to blind itself to the fact that there is before it, not a new proceeding, but an old proceeding sent back to it. The subsection plainly says that the Commission "shall proceed to a reconsideration of the proceedings".

What the Preferred Stock Committee relies on for its claim that on any re-reference to the Commission the proceeding should be stalled for six months for filing of new plans, and thereafter should be delayed for many months, if not years, for hearings on the new plans, is the provision of Section 77(d) that after the judge has approved the *original* petition in bankruptcy as properly filed, the debtor shall file a plan of reorganization within six months. But that plainly refers to a new proceeding. The judge is not approving a petition in bankruptcy when he remits a plan in an old proceeding to the Commission with a statement

of reasons why it should be corrected. The provision as to what is to happen after the filing of the original petition in bankruptcy, by its very terms, does not apply to what is to happen after remission of a plan to the Commission.*

2. The Preferred Stock Committee has no standing to present the other questions which it seeks to present, since they were not raised by it in the Courts below, and such questions are also without merit.

In a list of questions (Petition, pp. 7-8) the Preferred Stock Committee seeks to raise questions in addition to the so-called "important" question discussed above. In all, six questions are listed. Questions Nos. 2 and 3 are the same question already discussed. The other questions, which the Preferred Stock Committee is now seeking to raise for the first time in these proceedings, will be discussed in order.

(a) *As to Question 1.* The Committee seeks to raise the question whether a District Court, in referring a plan of reorganization back to the Commission under Section 77, may limit the scope of the proceedings before the Commission. This question was not raised in any form by the Preferred Stock Committee in the District Court. (See objections made by that Committee in the District Court, attached as Appendix F to its Petition, pp. 67-74.) Nor was such question presented to the Circuit Court of Appeals.

*The technical nature of the contention of the Preferred Stock Committee plainly appears from its inequitable argument that even if the Commission reached a correct conclusion after the reference back, its action must be set aside because it reached that conclusion too soon. Its Petition states (p. 14):

> "It is immaterial that the Commission might have reached the same conclusion that it did in its order dated May 1, 1944, approving the plan of reorganization as of January 1, 1944, had it on the re-reference followed the specific directions in Subsection (d). The fact remains that it did not follow the directions of law as are specificially provided for in Subsection (d), Section 77 of the Bankruptcy Act. The Interstate Commerce Commission was created by Act of Congress. It has only such powers as are given to it by Acts of Congress, and Section 77 of the Bankruptcy Act, since it is mandatory, must be strictly adhered to by the Commission in the exercise of its jurisdiction."

The Preferred Stock Committee in the first instance merely adopted the Debtor's statement of points on appeal to the Circuit Court of Appeals. Later the Committee received permission to file a new statement of points in the Circuit Court of Appeals, which it printed as Appendix A to its brief in that Court (Additional Transcript of Record herein, pp. 1-5). Neither the Debtor's statement of points nor the Committee's new statement of points on appeal contained the point now being made.

Even if the Committee had standing to make the point, the point is completely without merit, because the order of the District Court did not in any way limit the Commission, but simply made suggestions to the Commission regarding defects in the plan theretofore certified by the Commission. The order referred the proceeding back to the Commission "for further action in accordance with the applicable provisions of Section 77 of the Bankruptcy Act" (R., p. 300).

(b) *As to Question 4.* The Committee seeks to present the question whether the plan of reorganization approved by the Commission, the District Court and the Circuit Court of Appeals is "fair and equitable" and in the "public interest", in view of the alleged conflict between the Congress of the United States and the President on the one side and the Interstate Commerce Commission on the other as to the meaning of these words and the discretion thereby given to the Commission. Here again is a point not made in the District Court or in the Circuit Court of Appeals. It therefore cannot be made in this Court.

The point, in effect, is that members of Congress, the President, and members of the Interstate Commerce Commission have made statements of their views regarding public policy in connection with railroad reorganizations,

and that there may be some legislation some day changing Section 77.* But this Court has plainly stated in the *Denver & Rio Grande* case that courts must proceed with dispatch under existing legislation, and cannot wait with an eye to possible new legislation. *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 66 S. Ct. 1282, 1291

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* The Preferred Stock Committee states (Petition, p. 23) that the Commission knows that in the *Rock Island* case gross injustices have been done stockholders. There is not a line in Commissioner Mahaffie's testimony before the Senate Committee on Interstate Commerce quoted in the Committee's petition which would so indicate. On the contrary, Commissioner Mahaffie showed, in his testimony before the same Senate Committee, that if the Rock Island earnings from 1931 to 1944, inclusive, were applied to the new Rock Island capitalization, such earnings would leave a very small return for the new common stock. The testimony was as follows:

"Mr. Mahaffie. This sheet that I have just handed you is an analysis of the average earnings for the 15 years 1931 to 1944, inclusive, available for the preferred and common stock under the plans that the Commission has approved.

You will note, taking the Rock Island, that for that 15 year period it works out per common share at 56 cents on the average. For the Denver it shows nothing. That property lacked a million of earning anything on the average for its new preferred stock. The Missouri Pacific System did better. It earned $2.50 a share, on its new common. In that 15-year average, you will note that the fat war years are included. The New Haven shows $2.09 on its new common stock. The Frisco, 27 cents. Cotton Belt, nothing.

Now, that of course includes the depression. It includes also the war years, but if we take only the ten years ending with 1944, 1935 to 1944 inclusive, we find those figures are not very greatly affected. For the Rock Island it would be $2.29 in those 10 years.

Senator Reed. That is on the common stock?

Mr. Mahaffie. That is on common stock.

The Chairman. The Rock Island would earn what?

Mr. Mahaffie. $2.29 per share for those 10 years, including the excellent war years.

* * * * * *

"Senator Reed. If you took your original capitalization, how would the common and preferred stock have fared?

Mr. Mahaffie. I haven't figured that on the original capitalization, but I think they would not have fared so well, because this stock is issued in most cases to the old bondholders. That is what the old bondholders are getting in satisfaction of a part of their claims as bondholders. Referring to the statement I made, that the Commission is sometimes said to fix its capitalizations on the basis of depression earnings; if you take the 10 years, 1932 to 1941, which are mostly depression, but 1941 was not a bad year, and 1936 was not a bad year.

Senator Reed. And 1937.

Mr. Mahaffie. 1937 was not bad. But in that 10-year period there was a deficit on the Rock Island before there was anything available for the stock, authorized in the approved plan, preferred and common, of $2,551,634 a year. * * * I cite them [these figures] only for this purpose, to show that the Commission does not base these plans on the earnings of the depression years." (Published Hearings on S. 1253, of Committee on Interstate Commerce, United States Senate, 79th Congress, Second Session, pp. 526-7.)

(1946). Proposed amendments to Section 77 are perennial, and probably will be perennial for years to come. No railroad would ever be reorganized if the courts and the Commission should wait for the enactment of such legislation. The Rock Island Section 77 reorganization proceeding has already been pending over 13 years.

(c) *As to Question 5.* This question, as expressed, is difficult to understand. Its purport seems to be that in Section 77 proceedings the Commission *must* present a plan which gives something to the stockholders as well as the creditors, regardless of the value of the railroad system involved. Here again is a point not raised by the Preferred Stock Committee in the District Court (see Appendix F to Petition, pp. 67-74), or in the Circuit Court of Appeals (Additional Transcript of Record, pp. 1-5). The Preferred Stock Committee itself concedes that its contention that the Commission is required to preserve the equity of stockholders regardless of the value of the railroad property is contrary to the decisions of this Court (Petition, pp. 22, 29).

The point is, of course, without merit, for if there is insufficient value in the system to meet the creditors' claims, the stockholders cannot constitutionally be permitted to participate. This is a doctrine established by a long line of decisions in this Court. *Northern Pacific Ry.* v. *Boyd,* 228 U. S. 482 (1913); *Case* v. *Los Angeles Lumber Products Co., Ltd.,* 308 U. S. 106 (1939); *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.,* 318 U. S. 523 (1943); *Ecker* v. *Western Pacific R. Corp.,* 318 U. S. 448 (1943).

The deficiency claims of all creditors, that is, the claims not satisfied by the valuation found by the Interstate Commerce Commission, total over $145,000,000, taking all the new securities authorized by the Commission having a face

value at face value, and the new no-par value common stock at $50 a share, the value which it was adjudicated to be worth by the Commission and the District Court, their action being affirmed by the Circuit Court of Appeals (R., pp. 259, 237-243, 252-254, 301-302). The creditors' deficiency claims are shown by the following table:

Claims	Claim at Jan. 1, 1944	Deficiency taking new common at $50
General Mortgage	$ 86,213,400	$ None
C. & M. First Mortgage	5,286,000	None
First and Ref.	156,870,859(A)	57,606,900
Secured 4½s	59,021,174	18,569,382
C. O. & G.	8,296,867	872,239
St. P. & K. C. S. L.	27,495,118(A)	13,404,485
R. I. A. & L.	16,362,500	5,922,916
B. C. R. & N.	16,912,500	9,539,383
Convertible 4½s	47,697,440	39,293,262
General creditors	500,000	369,614
Total	$424,655,858	$145,578,181

(A) Includes bonds, now outstanding, formerly pledged for bank loans.

(d) *As to Question 6.* This is a contention that interest on creditors' claims accrued during the bankruptcy proceeding should be ignored in determining whether there is any equity for stockholders.

Not only was this point not made by the Preferred Stock Committee in the District Court or in the Circuit Court of Appeals, but that Committee specifically contended to the contrary. One objection in the District Court was: "The Plan as modified is unfair and inequitable in that it does not follow the rule of the Supreme Court of the United States in *Consolidated Rock Co.* v. *DuBois,* 312 U. S. 510, holding that interest on a claim has the same rank as the principal of that claim in reorganization" (Appendix F to Petition, p. 68). The identical contention was made in substantially the same words before the Circuit Court of

Appeals in the Preferred Stock Committee's new statement of points (Additional Transcript of Record, p. 4).

Furthermore, the Commission in giving recognition in the Rock Island plan to unpaid interest accumulated on the claims of secured creditors was merely following what it had done in the Milwaukee and Western Pacific Section 77 plans, which were upheld on that specific point by this Court. *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523 (1943); *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448 (1943).

Conclusion.

The Preferred Stock Committee seeks to present no question having any substance or merit.

Only one of the questions it seeks to raise here was put forward in the Courts below. That one question is the technical procedural point that if a plan is sent back by the District Court to the Commission for any correction, no matter how slight, the Commission must proceed "*de novo*" and wait at least six months before even considering whether to make the correction. That point has been made by the Preferred Stock Committee below and is sought to be made here only to obtain further delay in a proceeding which this Court said eleven years ago should be consummated with all possible speed. *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648 (1935).

The petition of the Preferred Stock Committee for a writ of certiorari should be denied.

Dated, November 1, 1946.

Respectfully submitted,

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